

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:IDD:IND:TL-N-197-99
TSSinnott

date:

to: Chief, Planning & Special Programs, Indiana District
Attn: Margie Duncan

from: Assistant District Counsel, Indiana District, Indianapolis

subject:

EIN: [REDACTED]

Taxable Years: [REDACTED] and [REDACTED]

DISCLOSURE STATEMENT

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This memorandum is in response to your oral request for an advisory opinion pertaining to the taxpayer referenced above. The Issue, and our Conclusion, as well as the Facts and our Analysis are set forth below.

ISSUE

From which date should interest be computed on the taxpayer's deficiencies in income tax which have been determined for the taxable years [REDACTED] and [REDACTED]?

CONCLUSION

We conclude that interest on the [REDACTED] deficiency should not begin to run until March 15, [REDACTED], the due date of the taxpayer's [REDACTED] return. We further conclude that interest on the [REDACTED] deficiency should not begin to run until [REDACTED], the date on which the taxpayer received its [REDACTED] refund.

FACTS

The taxpayer, [REDACTED], filed its Federal Income Tax Returns, Forms 1120, on a calendar year basis. These corporate returns are normally due to be filed on or before March 15.

As a result of an audit, the Service determined deficiencies in income tax for the taxable years [REDACTED] and [REDACTED] in the respective amounts of \$[REDACTED] and \$[REDACTED]. The taxpayer has agreed to this determination. However, the taxpayer asserts that, even considering these deficiencies, no interest should begin to accrue until [REDACTED], the date it received its refund. The revenue agent asserts that interest on the deficiencies begins to run on April 15, [REDACTED]. As discussed in detail below, we agree with the taxpayer as to the starting date of interest on the [REDACTED] deficiency ([REDACTED]). However, we disagree with the taxpayer's assertion of when interest begins to run on the [REDACTED] deficiency.

The taxpayer, pursuant to an extension, timely filed its [REDACTED] Form 1120 in [REDACTED]. In doing so, it reported an overpayment in the amount of \$[REDACTED] and elected to apply that amount to its [REDACTED] estimated tax payments. However, since the taxpayer did not elect any specific quarter, the carryover credit was applied to the first quarter of [REDACTED].

The taxpayer was required to make estimated tax payments for the taxable year [REDACTED] in the amount of \$[REDACTED] for each quarter. For the first quarter, the taxpayer did not make any additional estimated tax payments. However, the \$[REDACTED] carry over from [REDACTED] resulted in an overpayment for that quarter in the amount of \$[REDACTED] which was carried over to the second quarter. Moreover, this amount well exceeded the [REDACTED] deficiency of \$[REDACTED].

Again, for the second quarter of [REDACTED], the taxpayer did not make any additional estimated tax payments. However, the \$[REDACTED] carry over from the first quarter resulted in an overpayment for the second quarter in the amount of \$[REDACTED] which also far exceeded the [REDACTED] deficiency of \$[REDACTED].

For the third quarter of [REDACTED], the taxpayer made an additional estimated tax payment in the amount of \$[REDACTED]. That, coupled with the \$[REDACTED] carry over from the second quarter, resulted in an overpayment for the third quarter in the amount of \$[REDACTED], which was carried over to the fourth quarter. That amount also exceeded the [REDACTED] deficiency of \$[REDACTED].

The taxpayer did not make any additional estimated tax payments for the fourth quarter. However, the \$[REDACTED] carried over from the third quarter resulted in an overpayment for the fourth quarter in the amount of \$[REDACTED]. Again, that amount far exceeded the [REDACTED] deficiency.

Pursuant to an extension, the taxpayer timely filed its [REDACTED] Form 1120 in [REDACTED]. That return reflected an overpayment in the amount of \$[REDACTED]. Of that amount, the taxpayer elected to apply \$[REDACTED] to its estimated tax payments for [REDACTED]. Since the taxpayer did not elect a particular quarter, that amount was applied to the estimated tax payment due on [REDACTED]. The remaining balance of the [REDACTED] overpayment, \$[REDACTED], was refunded to the taxpayer on [REDACTED].

The taxpayer has not yet filed its [REDACTED] return. Given its history, the taxpayer will most likely file for an extension and then file its return in [REDACTED]. However, we have secured a transcript for [REDACTED] which reflects the \$[REDACTED] carryover credit and a \$[REDACTED] estimated tax payment, made on [REDACTED]. The transcript does not reveal any other estimated tax payments for [REDACTED].

The revenue agent recently spoke with the taxpayer's Chief Financial Officer (CFO) who verified that no other estimated tax payments have been made for [REDACTED]. However, the CFO stated that the taxpayer's accounting firm prepared projections for [REDACTED] which show that there will be no tax liability for that year. Those projections are based on technical issues regarding its LIFO reserve and other items resulting from the taxpayer's recent election for S Corporation status. As a result, it appears that no part of the [REDACTED] overpayment, including the \$[REDACTED] credit carry over, has been utilized to pay any part of the taxpayer's [REDACTED] income tax liability.

ANALYSIS

In general, the government is entitled to interest on a deficiency in tax for the period that the tax was due and unpaid. I.R.C. § 6601(a); Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978). If a deficiency in tax is determined after the taxpayer elected to credit a return overpayment against its estimated tax liability for the next succeeding year, interest will begin to accrue on the amount of the deficiency equal to the amount of the return overpayment as of the effective date of the credit elect. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476.¹ Pub. L. No. 98-369, 98 Stat. 494. Revenue Ruling 77-475 provides:

[i]f an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, **the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election.**

1977-2 C.B. at 476 (emphasis added). Accordingly, interest on the deficiency in the prior year begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356. However, the deficiency only becomes both due and unpaid, and thus triggers the running of interest on that deficiency, when the overpayment balance, after the application to the succeeding tax year's estimated taxes, is less than the deficiency for the overpayment year.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service generally was crediting

¹In 1983, the Service revoked Revenue Ruling 77-475. Rev. Rul. 83-111, 1983-2 C.B. 245. However, in response to tremendous public criticism and expected Congressional action, the Service promulgated Revenue Ruling 84-58, 1984-1 C.B. 254, which reinstated and modified Revenue Ruling 77-475 on March 30, 1984.

a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding tax year unless the taxpayer attached a statement to its return that designated otherwise. However, in May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), the Court of Federal Claims concluded that the assumption behind the default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be deemed to be credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer did not designate the particular installment of estimated tax against which to apply the return overpayment **and** the installments of estimated tax due prior to the filing of the prior year's return were fully paid without the application of the return overpayment. May Department Stores Co. v. United States, *supra*. On August 4, 1997, the Service acquiesced in the May Department Stores decision. May Department Stores Co. v. United States, AOD CC-1997-008.²

In light of the May Department Stores decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under I.R.C. § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated tax under I.R.C. § 6655 with respect to such year.

²The May Department Stores action on decision provides

that, for deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment [of estimated tax] for the following year, and crediting of the return overpayment is not necessary to fully pay an installment of estimated tax due prior to the filing of the prior year's return, the reported overpayment will not be deemed to be credited to an installment of estimated tax due prior to the filing of the prior year's return.

May Department Stores Co. v. United States, AOD CC-1997-008 (Aug. 4, 1997).

The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date the prior year's tax became unpaid for purposes of I.R.C. § 6601(a). Prior to that date, the government has had the use of the funds with respect to the prior year's tax, and no interest is payable on the overpayment that is the subject of the taxpayer's election. See I.R.C. § 6402(b); Treas. Reg. § 301.6402-3(a)(5) and § 301.6611-1(h)(2)(vii). Interest should be charged from the point the prior year's tax is both due and unpaid. May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997); Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978); Rev. Rul. 88-98, 1988-2 C.B. 356.

Where the overpayment is not needed to satisfy any installment of estimated tax in the succeeding year, the overpayment would be treated as a payment of the succeeding year's income tax. Section 6513(d) provides that if any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises. See also I.R.C. § 6513(a) which provides that a payment of income tax made before the date prescribed for payment of the tax is considered paid on that date. The date prescribed for payment of tax is the time fixed for filing the return (determined without regard to any extension of time for filing the return). I.R.C. § 6151. Further, it is on this date that the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under I.R.C. § 6611(a) and (d). Thus, we conclude that the statute requires that an overpayment which the taxpayer elects to credit against estimated tax for the succeeding year must be treated as a payment against the next year's tax liability with an effective date no later than the due date of the next year's return.

The taxpayer's factual situation, for [REDACTED], does not fit within the fact pattern set forth in May Department Stores, supra or Sequa Corp. v. United States, 1998 U.S. LEXIS 8556 (S.D.N.Y. June 8, 1998). First of all, a portion of the taxpayer's [REDACTED] overpayment of \$ [REDACTED] was needed to satisfy the first and second installments of estimated taxes for [REDACTED] to avoid the addition to tax for failure to pay estimated tax under I.R.C. § 6655. As stated previously, the taxpayer did not make an estimated tax payment until the third quarter of [REDACTED], in the amount of \$ [REDACTED].

However, the taxpayer's factual situation for [REDACTED] has some similarity to that set forth in Sequa. Although the taxpayer had a [REDACTED] overpayment in the amount of \$ [REDACTED], it elected to receive \$ [REDACTED] of that amount as a refund and applied only \$ [REDACTED] as a credit toward its [REDACTED] estimated tax obligations. Moreover, although the transcript reflects that no other estimated tax payments have been received for [REDACTED], the taxpayer's projections for [REDACTED] indicate that there will be no liability for that year. Consequently, as in Sequa, no part of the [REDACTED] overpayment will be applied to the taxpayer's [REDACTED] liability.

The District Court case of Sequa stands for the proposition that interest on the deficiency for the first year should not begin to run where there has been no application of the overpayment to pay estimated taxes of subsequent tax years in order to avoid the addition to tax for failure to pay estimated taxes under I.R.C. § 6655, or the overpayment has been refunded. However, the Service disagrees in part with the Sequa decision concerning the starting date of deficiency interest when the overpayment is not utilized to pay the succeeding tax year's estimated taxes. It is the Service's position that in all cases, the overpayment is a payment of the succeeding year's income tax liability no later than the due date (without regard to extensions) of the succeeding year's income tax return. Therefore, it is the Service's position that even if the overpayment credit is not needed for the estimated taxes for the subsequent tax year, the latest date on which interest will begin to accrue on the subsequently determined deficiency for the first year will be the due date of the return, without extensions, for the second year. It is on this date that the deficiency for the overpayment year became both due and unpaid and interest should begin to run from that date. However, as noted below, if the overpayment is refunded before the due date of the return, interest on the deficiency will begin to run as of the date of the refund.

In the instant case, the balance of the [REDACTED] overpayment, even after the partial application to the first and second installments of estimated taxes for [REDACTED], exceeded the deficiency for [REDACTED] and, therefore, deficiency interest does not run from the due date of any of the installments of estimated taxes for [REDACTED]. Rather, the [REDACTED] overpayment is applied to the [REDACTED] tax liability, which arises as of the due date (without extensions) of the [REDACTED] return, March 15, [REDACTED], and interest on the [REDACTED] deficiency begins to run on that date.

The taxpayer's [REDACTED] deficiency (\$ [REDACTED]) is another matter. In filing its return for that year, the taxpayer reported an overpayment of \$ [REDACTED]. However, it elected to receive a refund, which was issued on [REDACTED], in the amount of \$ [REDACTED]. Only \$ [REDACTED] was carried over to [REDACTED] as a credit.

Since the refunded amount, which far exceeds the deficiency, was never applied to the taxpayer's [REDACTED] estimated tax payments, the deficiency was not due and unpaid until the date of refund, [REDACTED]. Consequently, interest on the [REDACTED] deficiency should not begin to run until that date.

We have discussed this matter at length with our National Office and they concur. If you have any questions concerning this opinion, please contact Attorney Timothy S. Sinnott at extension 6842. We have included herewith the taxpayer's administrative file.

RODNEY J. BARTLETT
Assistant District Counsel

By: _____
TIMOTHY S. SINNOTT
Attorney

Attachments:
As stated.